

# What is the Budget Preparation Process?

## Worksheet

The budget preparation process is the series of steps - from setting objectives and forecasting sales through preparing departmental budgets to consolidating and approving a master budget - that a company uses to plan its financial activities for a period.

## Questions

1. Which budget is typically prepared first?

- A) Cash budget
- B) Sales budget
- C) Production budget
- D) Master budget

2. A department budgeted \$20,000 and spent \$18,000. Is this variance favorable or unfavorable?

- A) Unfavorable
- B) Favorable
- C) Neutral
- D) Cannot be determined

3. What does the master budget consolidate?

- A) Only the cash budget
- B) Only the sales forecast
- C) All departmental budgets into one comprehensive plan
- D) Only the production budget

4. What is the last step of the budget preparation process?

- A) Setting objectives
- B) Forecasting sales
- C) Monitoring and analyzing variances
- D) Preparing the production budget

5. A company forecasts sales of 10,000 units. It wants 800 units of closing finished goods inventory and currently has 500 units on hand. How many units should the production budget target?

6. Using the 10,300 units from the production budget, each unit requires 2 kg of raw material at \$5 per kg. Find the total direct materials budget.

7. The marketing department budgeted \$50,000 for the quarter but actually spent \$54,000. Find the variance and its percentage.

8. Define: What is the first budget prepared in the process?

9. Define: What is a master budget?

10. Define: What is a favorable vs. unfavorable variance?

## Answer Key

1. B) Sales budget - Nearly all other budgets depend on the sales forecast, so it's prepared first.
2. B) Favorable - Spending less than budgeted is a favorable cost variance.
3. C) All departmental budgets into one comprehensive plan - The master budget combines every departmental budget plus the cash and financial statement budgets.
4. C) Monitoring and analyzing variances - After approval, actual performance is continuously compared to budget throughout the period.
5. Production Needed = Sales + Desired Closing Inventory - Opening Inventory  
Production Needed = 10,000 + 800 - 500 = 10,300 units
6. Material required = 10,300 units × 2 kg = 20,600 kg  
Material cost = 20,600 kg × \$5 = \$103,000
7. Variance = Actual - Budgeted = 54,000 - 50,000 = \$4,000 (unfavorable)  
Variance % = (4,000 / 50,000) × 100 = 8% over budget
8. The sales (revenue) budget - nearly all other budgets are built from its forecast.
9. The consolidated summary of all individual departmental budgets, including the cash budget, budgeted income statement, and budgeted balance sheet.
10. Favorable: actual costs are lower (or revenue higher) than budgeted. Unfavorable: actual costs are higher (or revenue lower) than budgeted.

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